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Mr. Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W., Room 700
Washington, DC 20006

Re: **Ex Parte No. 582 (Sub-No. 1)**
Major Rail Consolidation Procedures

Dear Secretary Williams:

Enclosed for filing in the above-captioned proceeding are an original and twenty-five copies of the **Initial Comments of Wisconsin Central System**, dated May 15, 2000. A 3.5-inch computer diskette containing the text of the comments in WordPerfect 7.0 format also is enclosed.

I have included an extra copy of this transmittal letter and of the comments, and would request that you date-stamp those items to show receipt of this filing and return them to me in the provided envelope.

Should any questions regarding this filing, please feel free to contact me. Thank you for your assistance on this matter.

Respectfully submitted,

Janet H. Gilbert
Attorney for Wisconsin Central System

JHG:tjl

Enclosures

cc: Parties of Record

198555

BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

INITIAL COMMENTS OF
WISCONSIN CENTRAL SYSTEM

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Dated: May 15, 2000

BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

INITIAL COMMENTS OF
WISCONSIN CENTRAL SYSTEM

Pursuant to the Advance Notice of Proposed Rulemaking ("ANPR") served herein on March 31, 2000, Wisconsin Central System ("WC") submits these initial comments on the proposed revision of the Board's rail consolidation procedures for so-called "major" transactions.

Overview

WC consists of three Class II railroads, one Class III carrier and a Canadian carrier. The railroads operate together as a coordinated regional network serving the upper Midwest and Canada. Fox Valley & Western Ltd. ("FVW") operates solely within the State of Wisconsin. Sault Ste. Marie Bridge Company ("SSMB") serves primarily the Upper Peninsula of Michigan, with trackage to Green Bay, Wisconsin. The system's Canadian link is via Algoma Central Railway Inc. ("ACRI"), which operates along the eastern shore of Lake Superior from Sault Ste. Marie to Hearst in the Province of Ontario, Canada. Wisconsin Central Ltd. ("WCL"), the largest member of the system, operates in Wisconsin, Michigan and Ontario, as well as in Illinois and Minnesota. Wisconsin Chicago Link Ltd. ("WCLL"), the system's newest member, is a terminal carrier which controls track in the Chicagoland area for managing interline connections with other railroads.

WC owns or operates 2,855 miles of rail line and employs approximately 2,200 people. Its principle gateways are: Chicago, Duluth/Superior, Green Bay, Milwaukee, Minneapolis/St. Paul and Sault Ste. Marie, Ontario. Over 88% of WC's traffic either originates or terminates on-line or is local (i.e., both originates and terminates on-line). Throughout its territory, WC competes head-to-head with efficient trucking lines operating over a well-maintained highway system. Competition also is provided by lake vessels, river barges and other rail carriers. Paper and other forest products account for 41% of the WC's gross freight revenues and minerals for 30%. Other commodities include industrial products, food and grain, scrap and commodities moved by WC's intermodal services.

Since WC's first operating subsidiary was created in 1987, a major focus for every employee has been on customer service. WC has been designated a Quality Carrier by *Logistics Management & Distribution Report* for 11 consecutive years, an unprecedented record among railroads. In addition, WC has received a number of "Quality Carrier" and "Railroad of the Year" awards from its customers.

The WC system benefits from the international acquisitions of its parent company, Wisconsin Central Transportation Corporation ("WCTC"). These include Tranz Rail in New Zealand, the Australian Transport Network (including Tasrail), and the English, Welsh & Scottish Railway in Great Britain. WC is able to share marketing, operating, labor and technology ideas with its overseas affiliates and to benefit from international best practices in many fields, including safety, service, operations and e-commerce. Its international exposure has also given WC's management the ability to experience first-hand rail operations under different forms of ownership, from private ownership of an integrated rail system to joint venturing to open access.

WC is uniquely positioned to comment on the concerns voiced by the STB and others that the rail industry is about to enter another round of significant mergers in the face of a prior round that brought costly services disruptions. WC is, in essence, a feeder line -- one of several hundred -- to the five or six railroads whose merger activity is of concern to the STB. And WC will, in all likelihood, remain a feeder line to the two or three transcontinental railroads the STB believes will result in this next round of mergers. WC believes its destiny is tied less to the number of Class 1 carriers that remains than to what the STB's new rules will do for the survival of the rail industry as a whole.

Over the last twenty years, U.S. railroads have become a world model of efficiency. Railroads haul 40% of the nation's intercity freight traffic (in ton-miles), yet rail's share of intercity freight revenue has fallen from 20% to 10%. WC believes the STB's intentions are good and that the Board truly wants to see the rail industry retain and improve its market share, but it appears the STB has concluded that the key to doing so is to prevent future mergers and instead encourage cooperative efforts among the major carriers. WC fears that the Board, in focussing on manipulating how a few mega Class I's choose to structure themselves, will lose sight of the real struggle the industry, as a whole, is facing as it seeks to remain a crucial component of the overall transportation market.

WC believes the STB should be concerned less with rules that try to control the number of large Class I's, there are and more with conditions that address efficient use of and access to the national rail network in a manner that leaves the network a viable, privately-owned, competitive option for the nation's shippers -- both for shippers located on the large remaining Class I's and those located on feeder line railroads; both for shippers moving bulk commodities and those moving general freight. If the STB is to consider new rules, it should not lose sight of the fact that its merger policy must achieve the goal of coordinating a North American network of rail lines that competes with a publicly-subsidized network of major highways. The STB needs to move from a micro view of a rail industry that may be evolving into two or three major transcontinental systems with numerous feeder lines, to a macro view of rail as part of a national and international transportation market. Only then can we evaluate consolidation in the industry in its true context.

The Chicago terminal is a case in point. The terminal is a major hub, in one way or another, for every Class I railroad, and is the interchange point for a number of regional and short lines, including WC. Huge volumes of rail business are handled and interchanged daily. Yet it is as sensitive to the slightest operational breakdown as it is to the worst of Midwest winters. It suffers from aging infrastructure, lack of attention from public funding sources and the inherent failure of the industry to work together to assure that rail can compete effectively for the nation's freight traffic. The industry has attempted to address these issues through the creation of a senior-level Chicago Planning Group focused on longer-term infrastructure issues, and a permanently staffed Chicago Transportation Coordination Office to solve day-to-day operating problems. WC is an active participant in both. In truth, some of the challenges that a terminal such as Chicago faces may actually be improved by fewer Class I players rather than more. The role of the merger rules should be to assure that, whatever the number of megacarriers carriers left, as those carriers continue to focus their marketing efforts on high volume, transcontinental and international shippers, there remains rail service, and hence rail competitive alternatives, for shippers who are not high volume, long distance transportation users.

Scope of Coverage of New Rules

Initially, we note a threshold determination that the Board should make regarding what transactions will be covered by any newly-adopted merger rules. It is widely understood that this proceeding is meant to address a finite number of potential transactions among a finite number of rail carriers that will ultimately result in two transcontinental rail systems, i.e. the combination of: a) either BNSF or UP; with b) either CN or CP; and/or with c) either CSXT or NS. WC has no objection to merger rules and policy specifically tailored to those types of mega-transactions, but simply replacing the existing "major" merger rules of 49 C.F.R. §§ 1180.0-1180.9 with new rules would sweep in other transactions technically classified as "major" (that is, involving two or more Class I carriers) but plainly of a radically different character. That would be the case, for example, with a transaction involving the KCS, or other smaller railroads that achieved Class I status subsequent to adoption of the new rules. There is an obvious and fundamental distinction between Class I, transcontinental mega-carriers and these much smaller entities, and similarly a distinction in how they should be treated for merger purposes.

Regardless of one's position on the need for new rules covering the "final" round of rail mega-mergers, the STB cannot ignore the fact that there is now a gap of close to $5 billion between the smallest Class I railroad and most other railroads in the class[1]. As part of this proceeding, or as a separate rulemaking proceeding, the STB should consider redefining the revenue threshold for Class I railroads or, certainly, at a minimum, the definition of what major

[1] The number of Class I railroads in North America has shrunk from roughly 60 in the late 1970s to seven in 1999 (BNSF, CSXT, CN/GTW/IC, KCS, NS, CP/Soo and UP). Five of these Class I systems had 1999 annual operating revenues in excess of $5 billion (with two reaching almost $10 billion), while one had roughly $3.5 billion in revenue. The remaining carrier (KCS) had revenues of roughly $500 million. In 1998, the STB revenue threshold for Class I carriers was roughly $260 million.

transactions should be encompassed in the new rules. The positions expressed in Ex Parte No. 582, and the potential remedies that the STB may ultimately propose in Ex Parte No. 582 (Sub-No. 1), will have vastly different impacts on railroads that seek to be multi-billion dollar, transcontinental railroads and those that continue to remain regional -- even where transactions involving the latter may fall into what the STB now considers to be "Class I" or "major" transactions.[2]

Rail Service

A predominant aspect of the United States rail system (and for that matter the North American rail system) is its essential nature as a network. Rail transportation is dependent on the performance of numerous interrelated functions by a multitude of parties. A break-down in one piece of the network causes unavoidable and substantial disruption throughout the system. The result is that, to one degree or another, service unreliability is a problem for the entire industry, not just for those carriers whose operational difficulties start the cascading effect. While WC has, to a large extent, maintained fluid operations on its own lines, like many other regional and short line rail carriers, it cannot isolate itself or its customers from the effects of service problems elsewhere. Such problems will be a major focus of this proceeding and the subject of many parties' comments -- all of which merit the Board's serious attention. WC's specific focus in these comments is on preserving and enhancing efficient operations in major

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2 For example, the Board is considering adopting new rules to address "bottleneck" segments. Under current definitions of "major" consolidations, such rules would apply to all transactions involving Class I's, even though bottleneck situations on Class I mega-carriers -- traditionally involving high-volume, long-distance movements of bulk commodities -- are drastically different from single-served shippers on regional carriers -- where hauls are relatively short, density is low and product and geographic competition are an every-day concern.

terminal areas and, in turn, viable interchange between rail carriers -- both Class I's and regional and short line interline partners -- at those terminals.

As indicated above, the Chicago terminal is absolutely vital to WC's survival and success as a rail carrier. While WC serves other significant gateways (Minneapolis/St. Paul and Duluth/Superior being the most prominent), over 60% of WC's traffic passes through or is interchanged with other carriers in the Chicago switching district. If that terminal is not functioning properly, the resulting degradation of WC's service is serious and unavoidable. The recent condition of the Chicago terminal has been tenuous at best. Until just recently, problems in Chicago associated with the division of Conrail between CSXT and NS have had a significant effect on WC's operational and financial performance.

WC is largely dependent on other railroads -- both other line-haul carriers and terminal switching roads -- for the handling and interchange of WC's interline traffic in Chicago. WC does not have a major Chicago-area yard facility, and has no ownership interest in the two local switching carriers.[3] Other Chicago regional and short line carriers are in the same boat (I&M Rail Link would be one example), and presumably many other regional and short-line railroads face a similar situation at important interchange points across the nation. It is quite possible that new major mergers may make access to the interchange services that these carriers require increasingly more difficult. Where the concentrations of ownership and service disruptions that these mergers may bring threaten the neutral and efficient operation of the nation's major interchange terminals, the Board needs to act to assure that smaller railroads will remain "plugged in" to the rail network.

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[3] The Belt Railway Company of Chicago and Indiana Harbor Belt Railroad Company.

Terminal railroads have historically been owned by numerous line-haul rail carriers, and in WC's view their all-important neutrality resulted largely from that dispersion of ownership. The "last round" of major mergers to which the Board's new consolidation procedures are addressed could very well result in nearly every terminal switching carrier in the nation being owned by the same two railroads -- both with radically different needs, outlooks and motivations than the smaller carriers still dependent on the mega-carriers' terminal roads to stay linked with the rail network. Such orientation away from a broad community of interest would be problematic under the best of circumstances. But when (as unfortunately must be considered likely) merger-related service disruptions occur, the focus of "neutral" terminal roads may turn all too easily to serving only the pressing and distinct needs of their owners. Under these circumstances, it is neither cynical nor exaggerated to recognize that when capacity is exceeded even for a short time, smaller railroads will be the first ones pushed aside.

The same is of course true in instances where regional carriers rely on the large Class I carriers themselves, rather than terminal railroads, for the handling and accommodation of interchange traffic at significant gateways.[4] We note the recent and desirable attempts of Class I carriers to more closely coordinate joint operations in congested or complex terminal areas (Houston, southern California). But participating and benefiting equally in such arrangements is difficult for carriers disenfranchised with respect to terminal ownership and operating rights in the first place. The Board's new merger procedures should provide for a broad examination of such terminal and interchange issues -- not just how the merging carriers

4 In Chicago, for example, WC traffic not handled by BRC or IHB is often delivered to Class I connections via trackage rights and may be classified by those connections as well. A preference for these carriers' own trains over WC's interchange movements is equally devastating to WC's service.

will operate within a given terminal, but how other carriers in the terminal will be affected and how all interchange traffic in the terminal, especially that to and from smaller feeder railroads, will be handled. Where necessary to assure and promote efficient operations and continued access to the national rail system for non-mega carrier railroads, the Board should be willing to realign and refine ownership and operating interests in the terminal, with a less slavish adherence to the principle that merger conditions can never result in a better situation than existed previously.

Shortline and Regional Railroad Issues

WC comments here are related in some ways to those above for rail service, and again reflect the network characteristics of the nation's rail system as well as the need to insure that regional and short line carriers can remain viable and effective in such a system. The rail market which regional and short-line railroads, like WC, serve is intensely single carload, interline and short-haul, while the prime market of merged, transcontinental railroads will increasingly be intensely bulk/intermodal, single-line and long-haul. In WC's case, much of its traffic moves in single or multiple carloads, has an average length of haul of less than 275 miles, has a similarly limited length of haul on connecting interline carriers, and is very truck competitive. An inability to effectively compete for and serve such traffic would threaten the long-term economic viability of WC and other carriers who form the feeder portion of the U.S. rail system. Those impacts would, in turn, be felt by shippers (such as those in Wisconsin) who rely on such service and who, in a worse case scenario, may believe the answer to such competitive disadvantage is to relocate to points on these large rail lines. Those pressures, of course, have obvious consequences for the surrounding localities.

Yet the short-haul, carload, interline service that smaller railroads (and their railroads' customers, and the customers' communities) most urgently need from consolidated carriers is the service they may be least interested in providing. Those carriers will inevitably (and logically) focus on unit trains, bulk commodities, intermodal service, single-line long-hauls and reductions in train-handling expenses. Stopping to pick up individual carloads of traffic to move a short distance at what are often truck-competitive rates is not likely to be a high priority.[5] Indeed, elimination of certain of these situations has been a prime selling point of recent mergers: one significant benefit of the CSX/NS-Conrail transaction was diversion of intermodal traffic from truck to rail in the north-south, "I-95" corridor -- traffic that a stand-alone Conrail had not pursued because of the short haul involved.

But WC and numerous other short line and regional carriers will continue to exist after the transcontinental merger round, and must serve short-haul, interline traffic -- in conjunction with these large carriers -- efficiently and competitively if they are to survive. The Board's new merger procedures and policy should recognize and consider this dynamic, and create mechanisms by which, through haulage, pricing or operating rights, smaller railroads can effectively serve these vital markets and, thus, remain a viable component of the national rail system.

Such remedies may represent a new approach for the Board, but not for the industry as a whole. The AAR/ASLRRA Industry Agreement acknowledged and sought to address similar issues. The settlement agreement which WC reached with respect to the proposed BNSF/CN control transaction likewise provided opportunities for WC to obtain and

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5 Orientation away from such traffic has been reflected in an increasingly used phrase in rail lexicon --

serve relatively short-haul, interline traffic between WC points and BNSF/CN points that otherwise might move by truck. The agreement will allow WC to expand its merchandise freight service to points throughout the upper Midwest and Ontario, Canada, utilizing haulage rights on the combined BNSF/CN system which effectively expand WC's service territory by over 10,000 route miles. The agreement permits WC to do what it does best -- convert short haul merchandise traffic from truck back to rail. Using BNSF-CN haulage in the newly defined service territory overcomes the challenge of interchanging short-haul traffic to another railroad, a practice which has helped highway carriers securing a disproportionate share of regional freight moves.

Either the Industry Agreement or the WC agreement with BNSF/CN would serve as an appropriate starting point for the Board's development of policies and conditions on this subject. Whatever the approach, the ultimate goal should remain the same: to assure that, in the transcontinental railroad era, smaller railroads and their customers remain linked to the U.S. rail network, and that they are able to participate fully in the survival and development of that network which, we believe, is in the best interests of the nation's overall transportation needs. Ironically, it may be that this "last" round of mergers will actually be the key to opening up the transportation service market and bringing about innovative, cooperative arrangements between large and small carriers.

Competition

WC is concerned that the STB appears to be considering a wholesale change in its approach to analyzing rail mergers that will alter the fundamental economics of the industry.

(..continued)
"demarketing." WC has precious little traffic that it can afford to "demarket."

Moving from a standard of preserving competition to enhancing competition will have major impact on how the financial markets view investment in the industry. Moreover, the specific conditions or changes that result from such new standards could have an inadvertent but devastating effect on regionals and short lines when economic theories intended to apply to a few mega carriers find their way to applications throughout the industry.

WC believes that, to the extent the STB is going to consider conditions that open gateways, cure bottlenecks, revise the "one-lump" theory or give greater weight to "three to two" issues, these should remain case-by-case decisions and should not be encompassed in wholesale rule changes. Furthermore, the economic analysis applied to such conditions must continue to consider the effects of product, geographic and intermodal competition on a case-by-case basis and must be applied on a market-by-market basis, not shipper-by-shipper.

Downstream Effects

The Board seeks comments on proposed changes in the rules that would have the Board examine the likely "downstream" effects of a proposed transaction, including the likely strategic responses to that transaction by non-applicant railroads. WC expects that its comments on this topic will be the same as those of many other commenters: the concept may be well intended but whose crystal ball will the Board use?

The industry, both on the rail and shipper side, have talked for the last quarter century about the fact that ultimately the North American rail system will consist of a few transcontinental railroads. The Interstate Commerce Commission, and now the Surface Transportation Board, surely did not promulgate the current merger rules without the realization that the industry was headed in this direction. Presumably, there was always the temptation to have rules that considered the "what ifs" of tomorrow on the mergers of today. But formulating fair rules that base approval of a transaction, with or without conditions, on the speculations of the self-interests of opponents of a transaction or, for that matter, the arguably independent speculation of economists and public advocates, appears to be at best problematic. What rules will the STB promulgate to determine how it will select from among the dozens of various scenarios it will receive in any given transaction? And what rules will the STB promulgate to allow a transaction to be reopened when the downstream response it assumed would happen does not take place?

WC would find less objectionable rules that allow the Board to consider more than one pending merger at a time, provided that these later-filed merger or mergers are filed within a time frame that allows the Board to consider the impact of the later proposals on the first and still render a decision on the initial application in a timely manner. At least the Board can then consider "downstream" impacts based on proposals that are presumably financed, approved by the parties' boards of directors, and backed up by actual operating and marketing plans -- and not simply hypothetical fact patterns.

Cross-Border Issues

WC is in a unique position with respect to the issue of foreign control of railroads, since ACRI is a Canadian railroad and WC's parent, WCTC, has overseas rail operations in Great Britain, New Zealand, and Australia. While these control relationships are the reverse of that at issue here, we have a first-hand perspective of the issues associated with the operation of a rail system in one country by a company with roots in another. WC does not believe that any specific additions or modifications to the Board's rail consolidation procedures are necessary or desirable to address the subject of cross-border rail ownership. Individual cross-border issues can be dealt with as they arise, just has they have been in the past.[6] The Board should be wary of invitations to a more protective or parochial approach, especially in light of the ground-breaking movement toward seamless North American trade introduced by NAFTA as well as many other efforts by the U.S. to encourage cross-border investment.

We note that there is nothing inherently problematic with foreign ownership of U.S. railroads. GTW and Soo Line, two U.S. Class 1 railroads, were controlled by CN and CP, respectively, for most of the last century. While the scale of potential cross-border partnerships may be greater today, many of the underlying issues remain the same. With WCTC's overseas operations and the 1995 acquisition of ACRI, WC is familiar with the sensitivities at play here and with the skepticism and suspicion that can initially greet foreign owners. In every instance, however, such fears were overcome and rail service was significantly improved. We have no reason to believe that the results will be different with further foreign investment in U.S. railroads or further U.S. investment in foreign railroads.

Whatever their foreign ownership, railroads remain subject to the laws and regulations of the nation in which they operate. The presence of an intervening international border inevitably results in some demarcation of rail operations on either side of that border, and frequently operations in another country are conducted by a separate corporate entity. That is likely to be the case in the future as well. Under such circumstances, the fears expressed by several parties and relayed in the ANPR are unfounded. Even with "predominant foreign

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[6] See, e.g., Canadian National Railway Company, Grand Trunk Corporation and Grand Trunk Western Railroad Incorporated -- Control -- Illinois Central Corporation, Illinois Central Railroad Company, Chicago, Central & Pacific Railroad Company and Cedar River Railroad Company, Finance Docket No. 33556, Decision No. 37 (STB served May

control," ANPR at 9, a U.S. railroad is subject to the jurisdiction of the Board and the FRA,[7] the common carrier obligation and discrimination prohibitions of the Interstate Commerce Act, and the ability of the U.S. government to use those domestic assets in time of war. Rail consolidation regulations are not needed to recreate legal obligations that will remain in place in any event.

Further, to the extent that a cross-border transaction would enhance efficient routings via a Canadian port such as Halifax, it is unclear how handicapping such competitive options through the Board's merger rules serves the shipper and public interest in adequate rail transportation. The Board's normal consideration of diversion impacts and preservation of essential services in a consolidation proceeding can occur just as effectively whether traffic is potentially drawn to a port in Canada or another port in the United States.

The growing and successful trend of foreign investment in rail operations includes not only WCTC but a number of other U.S. rail companies. In rail, as in many other areas, barriers to cross-border investment and trade are coming down, not going up. Specific merger rules or policies intended to "address" cross-border issues would inhibit rather than foster such trends, without good reason. The Board should not include such provisions in its revision of the major rail consolidation procedures.

(..continued)
25, 1999) at 43 (specific accommodation made for employees who could face difficulty following work to Canada).

7 We see no reason why the FRA cannot effectively address any real or perceived safety issues associated with cross-border rail ownership through its own jurisdiction over U.S. operations and rulemaking authority. Such actions, however, can and should be undertaken directly by the FRA, not secondhand through the STB's merger regulation procedures. See Canadian Pacific Ry. Co. v. STB, 197 F.3d 1165 (D.C. Cir. 1999).

Conclusion

In sum, WC is not convinced that the current rules governing major rail consolidations need wholesale revision. However, if the STB is inclined to promulgate new rules, it is imperative that the STB bear in mind three points: (1) rules designed to address concerns with transcontinental mergers resulting in 2 or 3 mega carriers will not and should not apply to other mergers; (2) new rules must preserve the rail network that serves customers on transcontinental, regional and short line railroads alike and allows rail to compete for a reasonable share of the nation's freight transportation market; and (3) the new rules should not cause a change in the fundamental economics of the rail industry as developed in prior consolidations. Changes directed to the evolution to transcontinental rail systems may be appropriate but wholesale redrafting of rail competition rules is unwarranted.

Respectfully submitted,

By:________________________

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Dated: May 15, 2000

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing **Initial Comments of Wisconsin Central System** has been served by first class mail, postage prepaid, on all parties of record in this proceeding, as identified on the service list issued by the Surface Transportation Board on April 28, 2000 and revised on May 10, 2000.

Janet H. Gilbert

Dated: May 15, 2000